

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name South County Sewer & Water Authority	County Kalamazoo
Audit Date 3/31/05	Opinion Date 6/6/05	Date Accountant Report Submitted to State: 9/28/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Seber Tans, PLC			
Street Address 555 W. Crosstown Parkway, Suite 304		City Kalamazoo	State MI
Accountant Signature <i>Allen L Tans, CPA</i>		ZIP 49008	Date 9-28-05

SOUTH COUNTY SEWER AND WATER AUTHORITY
FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION
For the Years Ended March 31, 2005 and 2004

TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditors' Report	1
Management's Discussion and Analysis	2-5
Financial Statements	
Statements of Net Assets	6
Statements of Revenues, Expenses and Changes in Net Assets	7
Statements of Cash Flows	8
Notes to Financial Statements	9-17
Supplemental Information	
Schedule of Operating Expenses Compared to Budget	18
Schedule of Principal and Interest Payments - \$6,100,000 Kalamazoo County General Obligation Bonds Dated December 1, 1998	19

SEBER TANS, PLC

CONSULTANTS & CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
South County Sewer and Water Authority

We have audited the accompanying financial statements of South County Sewer and Water Authority as of and for the years ended March 31, 2005 and 2004 as listed in the table of contents. These financial statements are the responsibility of the South County Sewer and Water Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the financial position of South County Sewer and Water Authority at March 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We applied certain limited procedures consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying financial information listed as supplemental information in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements of the South County Sewer and Water Authority. The supplemental information has been subjected to the auditing procedures applied in the audits of financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Seber Tans, PLC

Seber Tans, PLC
Kalamazoo, Michigan
June 6, 2005

**SOUTH COUNTY SEWER AND WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Using This Annual Report

This annual report consists of the Statements of Net Assets, the Statements of Revenues, Expenses and Changes in Net Assets, and the Statements of Cash Flows. Along with the footnotes, they provide detailed financial information concerning the Authority. This section, Management's Discussion and Analysis, is intended to provide an overview of the Authority's financial condition, results of operations, and other key information.

Financial Overview

In analyzing the Authority's financial position, it is important to recognize the mission of the Authority. From a financial perspective, the Authority's core objective is to manage the long-term costs of providing sanitary sewer service to the businesses and residents (collectively the Users) of participating Municipalities. The Authority acts as an agent of the participating Municipalities. The quarterly amounts charged to Users approximate the operating costs incurred by the Authority in providing sanitary sewer. In addition to the long-term operating costs of providing sanitary sewer, the Authority is responsible for the repayment of bonds and other debt obligations incurred to finance the construction of the sanitary sewer system and used to purchase long-term sewer capacity. Charges for capital costs are generally made to the benefiting party, the land owner and/or developer, at the time the infrastructure is constructed.

A significant non-cash expense of the Authority is depreciation. Depreciation expense represents costs associated with the construction of the sanitary sewer system that are financed by long-term debt obligations and assessments on the Users properties. Principal payments from assessments and principal payments on long-term financing are not reflected as revenues or expenses of the Authority. For budgeting purposes and for setting user rates, management does not consider depreciation expense.

	2005	2004
Total operating expense	\$ 342,730	\$ 329,196
Less depreciation and amortization	(184,369)	(186,857)
Operating expenses, net of depreciation and amortization	158,361	142,339
Users	549	547
Annual cost per User	\$ 289	\$ 260
Monthly cost per User	\$ 24	\$ 22

The Authority's costs of operating are primarily affected by treatment charges from the City of Kalamazoo and the costs of services, both contracted and employed personnel. The sanitary sewer system covers a geographic area of approximately 5 square miles, including 15 miles of pipeline. It is envisioned that approximately 50 new users will connect to the sewer system over the next ten years. As new users connect to the sanitary sewer system, it is anticipated that the cost per user will decrease.

The Authority's net assets increased approximately \$12,000 in 2005 and decreased approximately \$100,000 in 2004. Net assets increased in 2005 primarily as a result of contributed capital. The authority recognized contributed capital of \$62,410 as 6 new users connected to the sanitary sewer system. Also, in 2005 the Authority recognized \$176,833 of contributed capital as the result of debt

**SOUTH COUNTY SEWER AND WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

forgiveness from two participating Municipalities. The debt forgiveness related to non-bond debt provided to finance first year operating activities. It is not anticipated that the Authority will be the beneficiary of debt forgiveness in the future.

The decrease in net assets for 2004 resulted primarily from the excess of depreciation and financing expenses over capital contributed by new Users connecting to the system. In years that the Authority does not construct sanitary sewer, it is anticipated that net assets will decrease, primarily as a result of depreciation expense.

	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Capital assets	\$ 6,464,470	\$ 6,637,216	-2.6
Other assets	<u>4,187,697</u>	<u>4,499,248</u>	-6.9
Total assets	10,652,167	11,136,464	-4.3
Long-term liabilities	4,470,520	4,820,520	-7.3
Other liabilities	<u>456,429</u>	<u>602,744</u>	-24.3
Total liabilities	4,926,949	5,423,264	-9.2
Net assets (deficit):			
Invested in capital assets net of related debt	1,597,432	1,448,502	10.3
Restricted assets	4,115,967	4,312,793	-4.6
Unrestricted assets (deficit)	<u>11,819</u>	<u>(48,095)</u>	124.6
Total net assets	<u>\$ 5,725,218</u>	<u>\$ 5,713,200</u>	0.2

The significant reduction in other liabilities and unrestricted deficit resulted primarily from the Municipalities debt forgiveness of \$176,833.

Restricted net assets represent the total of all assets restricted for the repayment of bond obligations and for future capital improvements. Bond obligations payable exceeded the total restricted net assets of the Authority by \$704,553 and \$832,727 at March 31, 2005 and 2004. This shortfall in assets available to repay the debt results from a number of factors: (1) The Users were originally assessed 80% of the estimated construction cost for the sanitary sewer. (2) As is typical, Users were charged a lower initial cost per user in anticipation of normal future growth over time. (3) One User comprising 26% of the total assessment was granted a reduction of \$468,030 from the amount the User was originally assessed. (4) The growth rate anticipated at the time of construction was 10 new units (homes) per year; the growth rate the system has experienced has been 7 new units per year. Over time it is anticipated that the expected average growth rate will be met.

The Authority's ability to manage the repayment of bond debt at a reasonable cost to the Users is a key objective of Management. Management semi-annually reviews the growth rate and estimates future cash flows, and to the extent necessary, Management has implemented a debt service charge for each User on the system. Management annually recommends adjustments to the debt service charge based on a number of factors such as the number of new connection fees, interest rates earned

**SOUTH COUNTY SEWER AND WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

on investments, and the rate at which assessment and connection fee contracts are prepaid. The ultimate cost to the Users will depend chiefly on these three factors. The most significant factor affecting both the cost of bond repayment and operating costs is the growth rate.

	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Operating revenue	\$ 164,371	\$ 153,389	7.2
Operating costs	<u>342,730</u>	<u>329,196</u>	4.1
Net loss from operations	(178,359)	(175,807)	1.5
Net non-operating expenses	<u>(48,866)</u>	<u>(28,478)</u>	71.6
Net loss	<u>\$ (227,225)</u>	<u>\$ (204,285)</u>	11.2

Operating revenues increased by 7.2% from 2004 to 2005. This increase resulted from increases in the number of users. The increase in operating costs and net loss from operations resulted primarily from an increase in treatment charges from the City of Kalamazoo's regional treatment facility. The increase in net non-operating loss resulted primarily from an increase in the excess of interest expense over interest income. The Authority continued to have a significant negative net interest margin. The negative interest margin amounted to \$56,289 and \$25,836 for 2005 and 2004, respectively. The negative interest margin resulted primarily from two factors: 1) low interest rates and 2) an excess of debt payable over assessments receivable and investments. The low interest rates in the general market have resulted in a number of Users accelerating their payments on assessments. Under current market conditions, the Authority is unable to invest these funds (per required investment vehicles) at an interest rate that is equal to the cost of the debt (average cost for 20 year debt of 4.3%). The debt will not be redeemable in whole or in part until 2007. Management reviews the cost effectiveness of redeeming or refunding bonds on an annual basis.

As described earlier, the bonds payable exceeded interest bearing assets restricted for payment of bonds by \$704,553 and \$832,727 at March 31, 2005 and 2004, respectively. Also as described previously, the primary sources available to the Authority to reduce this negative margin are connection fees from User growth (new customers) and from debt service fees charged to all Users. The Authority Board closely monitors the debt requirements and each year makes recommendations to the participating municipalities for adjustments to the debt service fee as needed to maintain long-term surplus cash flow for debt repayment. The participating municipalities have, to date, increased debt service fees according to the recommendations.

Capital Asset and Debt Administration

The Authority incurred only minimal costs for repairs to the sanitary sewer in both 2005 and 2004. The Authority did not, therefore, incur any additional debt in either 2005 or 2004. In fiscal 2006 it is not anticipated the Authority will incur significant debt for repairs and/or replacements, as the sewer system was newly constructed in 1998. In fiscal 2006, the Authority partnered with Pavilion Township and implemented a sanitary sewer project along Sprinkle Road in Pavilion Township. The project is expected to cost approximately \$600,000 and will be financed by a combination of assessments, contributions, connections fees, and borrowings.

**SOUTH COUNTY SEWER AND WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Economic Factors and Next Year's Rates

Each year, the Authority monitors its cash flow for operating expenses and makes recommendations to the participating municipalities for rate increases necessary to fund operations and maintenance. It is anticipated that User growth and cost efficiency measures by Management, will minimize the effect of future operating cost increases over the upcoming year.

Contacting the Authority's Management

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact Rich Pierson, Director, or Cindy Chapman, Assistant Director, South County Sewer & Water Authority, at 269-321-8925.

SOUTH COUNTY SEWER AND WATER AUTHORITY
STATEMENTS OF NET ASSETS
March 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 30,181	\$ 126,874
Contracts receivable from municipalities, no allowance for doubtful accounts	200,000	250,000
Other contracts receivable, no allowance for doubtful accounts	20,000	30,000
TOTAL CURRENT ASSETS	<u>250,181</u>	<u>406,874</u>
OTHER ASSETS		
Contracts receivable, excluding current portion	1,995,373	2,212,612
Other contracts receivable, excluding current portion	160,447	172,570
Start-up costs, net of amortization	5,177	20,709
Bond issue discount, net of amortization	36,372	38,872
Restricted cash and investments	1,740,147	1,647,611
TOTAL OTHER ASSETS	<u>3,937,516</u>	<u>4,092,374</u>
PROPERTY AND EQUIPMENT		
Fixed assets, net of accumulated depreciation of \$814,235 and \$629,866	<u>6,464,470</u>	<u>6,637,216</u>
TOTAL ASSETS	<u>\$ 10,652,167</u>	<u>\$ 11,136,464</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Demand obligation payable	\$ ---	\$ 150,000
Accounts payable	23,539	18,843
Accrued interest	82,890	108,901
Current portion of contract debt payable	350,000	325,000
TOTAL CURRENT LIABILITIES	<u>456,429</u>	<u>602,744</u>
LONG-TERM LIABILITIES		
Contract debt payable, less current portion	<u>4,470,520</u>	<u>4,820,520</u>
TOTAL LIABILITIES	<u>4,926,949</u>	<u>5,423,264</u>
NET ASSETS		
Invested in capital assets, net of related debt	1,597,432	1,448,502
Restricted for debt service and other purposes	4,115,967	4,312,793
Unrestricted assets (deficit)	11,819	(48,095)
TOTAL NET ASSETS	<u>5,725,218</u>	<u>5,713,200</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 10,652,167</u>	<u>\$ 11,136,464</u>

See Accompanying Notes to the Financial Statements

SOUTH COUNTY SEWER AND WATER AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
For the Years Ended March 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
REVENUES		
Charges for services	\$ 164,371	\$ 153,389
OPERATING EXPENSES		
Salaries and wages	49,166	52,046
Fringe benefits	9,860	7,943
Contracted services	68,538	63,015
Utilities	11,925	12,105
Supplies	5,607	3,483
Maintenance and repairs	10,765	3,747
Depreciation and amortization	184,369	186,857
TOTAL OPERATING EXPENSES	<u>340,230</u>	<u>329,196</u>
OPERATING LOSS	(175,859)	(175,807)
NON-OPERATING REVENUES		
Debt service fees	20,455	12,843
Interest income on investments	13,314	13,912
Interest income on special assessments	135,730	180,924
Interest income on connection fee contracts	8,190	9,053
Miscellaneous revenue	---	48
TOTAL NON-OPERATING REVENUES	<u>177,689</u>	<u>216,780</u>
NON-OPERATING EXPENSES		
Interest expense	(213,523)	(229,725)
Amortization	(15,532)	(15,533)
TOTAL NON-OPERATING EXPENSES	<u>(229,055)</u>	<u>(245,258)</u>
LOSS BEFORE CONTRIBUTIONS	(227,225)	(204,285)
Capital contributed	<u>239,243</u>	<u>104,000</u>
CHANGE IN NET ASSETS	12,018	(100,285)
Net assets at beginning of year	<u>5,713,200</u>	<u>5,813,485</u>
NET ASSETS AT END OF YEAR	<u>\$ 5,725,218</u>	<u>\$ 5,713,200</u>

See Accompanying Notes to the Financial Statements

SOUTH COUNTY SEWER AND WATER AUTHORITY
STATEMENTS OF CASH FLOWS
For the Years Ended March 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from users	\$ 164,371	\$ 153,389
Cash payments to suppliers for goods and services	(92,139)	(81,643)
Cash payments to employees for services	(59,026)	(59,989)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>13,206</u>	<u>11,757</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Other non-operating revenues	20,455	12,891
Proceeds from connection fees	84,533	65,494
Proceeds from contracts with municipalities	267,239	270,036
Principal paid on contract debt	(325,000)	(325,000)
Interest paid on contract debt	(210,199)	(223,931)
Acquisition and construction of capital assets	(11,624)	(10,897)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(174,596)</u>	<u>(211,407)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest earned on investments and receivables	157,234	158,336
Net proceeds from (investments in) government obligations with maturities greater than 90 days or restricted for capital improvements or debt reduction	(92,537)	60,863
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>64,697</u>	<u>219,199</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(96,693)</u>	<u>19,549</u>
Cash and cash equivalents at beginning of year	<u>126,874</u>	<u>107,325</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 30,181</u>	<u>\$ 126,874</u>

See Accompanying Notes to the Financial Statements

	<u>2005</u>	<u>2004</u>
SUPPLEMENTAL DISCLOSURES		
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (175,859)	\$ (175,807)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	184,369	186,857
Increase (decrease) in:		
Accounts payable	<u>4,696</u>	<u>707</u>
TOTAL CHANGES IN ASSETS AND LIABILITIES INCLUDED IN OPERATING RESULTS	<u>189,065</u>	<u>187,564</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 13,206</u>	<u>\$ 11,757</u>

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE A - Summary of Significant Accounting Policies

Authority Formation and Mission

The South County Sewer and Water Authority (the Authority) was established by the Townships of Brady and Pavilion and the Township and Village of Schoolcraft, Kalamazoo County, Michigan. The Authority was incorporated in May, 1997, under the provisions of Act 233, Public Acts of 1955, as amended. The Authority is governed by a board composed of representatives of each of the constituent municipalities. The Authority was formed to operate, maintain, administer and manage a sewage collection and disposal system pursuant to Act 185 Public Acts of 1957, as amended, for the benefit of constituent municipalities.

A nineteen-year bond issue totaling \$6,100,000 financed the cost of the sewer collection system and lines. The bonds were issued in December, 1998. The \$6,100,000 debt will be repaid with proceeds from a twenty-year special assessment roll on benefiting property owners, revenue from new connection fees, and from debt service fees.

Statement on Accounting Policies

The accounting policies of South County Sewer and Water Authority conform to generally accepted accounting principles as applicable to governments. The Authority applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principle Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict or contradict Governmental Accounting Standards Board (GASB) pronouncements, in which case, GASB prevails. The Authority has elected not to follow FASB pronouncements and APB opinions issued after November 30, 1989.

Effective April 1, 2004, the Authority adopted GASB 34. The most significant change required by the adoption of GASB 34 was the reporting of net assets as shown in the accompanying Statements of Net Assets and the addition of the required supplementary information - Management's Discussion and Analysis. Certain reclassifications were made to the 2004 financial statements to comply with current classification. The Authority has not adopted GASB 40, "Deposits and Investment Risk Activities". GASB 40 is effective for fiscal years beginning after June 15, 2004. GASB 40 will affect the nature of the disclosures related to deposits and investment activities of the Authority.

Scope of Reporting Entity and Basis of Presentation

The financial statements of South County Sewer and Water Authority contain all the funds that are financially interdependent on the Authority's executive or legislative branches. The most significant manifestation in determining the reporting entity is financial interdependence. Other manifestations to be considered include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations, and accountability for fiscal matters. Another criterion used to evaluate potential component units for inclusion or exclusion in a reporting entity is the existence of special financing relationships regardless of oversight responsibilities. The Authority does not have any potential component units. Based on these criteria the Authority is considered a reporting unit and is not considered a component unit of the Townships.

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE A - Summary of Significant Accounting Policies (Continued)

Basis of Accounting

All activities of the Authority are accounted for in a single proprietary fund. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the statement of net assets. Net assets is divided by the following components: invested in capital assets-net of related debt, restricted for debt service and other purposes, and unrestricted.

Proprietary fund-type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. Activities of the Authority are accounted for by using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred. Operating activities include all revenues and expenses associated with sewer activities. Non-operating revenues and expenses relate primarily to financing and investing activities.

Use of Restricted Assets

Certain deposits and investments are restricted by contract and/or Township ordinance for debt service purposes, capital improvements, significant repairs and replacements and by Authority policy for future contingencies. Costs of capital improvements and significant repairs and replacements are funded first from restricted assets.

Fixed Assets

Fixed assets of the Authority are accounted for on a cost of services or "capital maintenance" measurement focus. Fixed assets are valued at cost. Donated fixed assets are stated at their fair market value on the date donated.

Depreciation of all exhaustible fixed assets is charged as an expense against operations. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets as follows: Sewer Lines - 40 years, Sewer Equipment - 7 years, and Office Equipment - 5 years.

Capitalized Interest

Interest costs on debt incurred to finance fixed asset additions is capitalized during the construction period. Interest is capitalized at the rate of the associated debt instrument based on the cost incurred on the related construction until such time as the sewer system is ready for service. The interest capitalized is added to the carrying cost of the sewer system.

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE A - Summary of Significant Accounting Policies (Continued)

Estimates

Preparation of financial statements in accordance with generally accepted accounting principles requires the use of estimates by management. Estimates are subject to change and, accordingly, actual results may differ from the estimates used in preparation of the accompanying financial statements. These financial statements include estimates primarily as to the depreciable lives and salvage values of fixed assets, and the current portion of contracts receivables.

Cash and Cash Equivalents

For purposes of the statements of cash flows, all highly liquid investments with a maturity of three months or less when purchased that are not restricted for capital additions or debt retirement are considered to be cash equivalents.

NOTE B - Cash, Deposits and Investments

The State of Michigan allows a political subdivision to authorize its treasurer or other chief financial officer to invest surplus funds belonging to and under the control of the entity into certain instruments described as follows: bonds and other direct obligations of the United States or an agency of the State of Michigan or its political subdivisions, or instrumentality of the United States; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank or savings and loan, which is a member of the Federal Deposit Insurance Corporation or a credit union which is insured by the National Credit Union. The Authority may invest in commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase; in United States government or federal obligation repurchase agreements; in bankers' acceptances of United States banks; in mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan and SEC regulated; or in surplus funds investment pools.

Depositories actively used by the Authority during each of the years were: Kalamazoo County State Bank and Investment Centers of America, Inc.

Balances at March 31, related to cash and cash equivalents and deposits (including certificates of deposit with greater than 90 day maturities at purchase) are detailed on the statements of net assets as follows:

	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 30,181	\$ 126,874
Restricted assets (See Note D)		
Bank deposits and money market accounts	469,672	1,327,583
United States government obligations	<u>1,270,475</u>	<u>320,028</u>
TOTALS	<u><u>\$ 1,770,328</u></u>	<u><u>\$ 1,774,485</u></u>

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE B - Cash, Deposits and Investments (Continued)

Cash, deposits and United States government obligations (including restricted assets) at March 31, as shown by carrying amount and bank balance and classified by categories of credit risk are itemized as follows:

	2005		2004	
	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash and deposits				
FDIC insured	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000
SPIC insured	17,603	17,603	500,000	500,000
Uninsured and uncollateralized	382,250	388,869	854,457	861,094
United States government obligations				
SPIC insured	788,078	774,092	---	---
Uninsured	482,397	482,397	320,028	312,313
TOTALS	<u>\$ 1,770,328</u>	<u>\$ 1,762,961</u>	<u>\$ 1,774,485</u>	<u>\$ 1,773,407</u>

NOTE C - Contracts Receivable and Other Contracts Receivable

Contracts receivable from municipalities represent balances from the special assessment roll originating in 1996. The roll will be collected over a twenty-year period, plus interest at 1% over the Authority's cost of funds on the unpaid balance. Individual residents and businesses are legally responsible for payment of the fees. This disperses the credit risk over approximately 450 parcels in the geographic area. The assessments become priority liens on each of the assessed parcels. Additionally, unpaid portions of assessments due become tax liens due and payable in the same manner as property taxes. The amount shown under current assets represents the principal portion of special assessments estimated to be collected in the current year.

Contracts receivable at March 31, consists of the following:

	<u>Current Portion</u>		<u>Total</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Brady Township	\$ 165,000	\$ 160,000	\$ 1,790,646	\$ 1,983,149
Pavilion Township	35,000	90,000	404,727	479,463
	<u>\$ 200,000</u>	<u>\$ 250,000</u>	<u>2,195,373</u>	<u>2,462,612</u>
Less current portion			<u>(200,000)</u>	<u>(250,000)</u>
TOTALS			<u>\$ 1,995,373</u>	<u>\$ 2,212,612</u>

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE C – Contracts Receivable and Other Contracts Receivable (Continued)

Other contracts receivable (connection fees) consist of customers hooking up to the system who are not part of the Municipalities' special assessment. Contract terms vary and include interest, generally at 5.5%. The Authority sets the interest rate annually based on the local interest rate market. Other contracts receivable are secured by property liens on the related parcels. The amount shown under current assets represents the principal portion of other contracts expected to be collected in the current year.

Other contracts receivable at March 31, consists of the following:

	Current Portion		Total	
	2005	2004	2005	2004
Connection fees	\$ 20,000	\$ 30,000	\$ 180,447	\$ 202,570
Less current portion			(20,000)	(30,000)
TOTALS			\$ 160,447	\$ 172,570

NOTE D - Restricted Assets

Deposits and investments at March 31, are restricted for the following purposes:

	2005	2004
Reserved for payment on contract debt issued December 1, 1998	\$ 1,403,675	\$ 1,310,669
Reserved for construction of Sprinkle Road sewer	256,472	256,942
Reserved for capital improvements	80,000	80,000
TOTAL RESTRICTED DEPOSITS AND INVESTMENTS	\$ 1,740,147	\$ 1,647,611

The board determines the reserve for capital improvements annually. Connection fee receipts, to the extent they are not needed for current debt service requirements, are deemed available for capital improvements. The reserve for capital improvements is also provided to cover the Authorities' exposure related to the self-insurance against risk of loss from damage that may be incurred by users of the sewer system from sewer operations/ backups and construction. See Note J.

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE E - Property and Equipment

The property and equipment of the Authority, together with changes therein for the year ended March 31, 2005, are detailed as follows:

	Cost			Balances March 31, 2005
	Balances April 1, 2004	Additions	Disposals	
Office equipment	\$ 7,921	\$ ---	\$ ---	\$ 7,921
Sewer system	7,256,727	11,623	---	7,268,350
Sewer equipment	2,434	---	---	2,434
Total Property and Equipment	7,267,082	11,623	---	7,278,705
	Accumulated Depreciation			Balances March 31, 2005
	Balances April 1, 2004	Additions	Disposals	
Office equipment	\$ 3,395	\$ 958	---	\$ 4,353
Sewer system	625,688	183,064	---	808,752
Sewer equipment	783	347	---	1,130
Total Accumulated Depreciation	629,866	184,369	---	814,235
Net Property and Equipment	<u>\$ 6,637,216</u>	<u>\$ (172,746)</u>	<u>\$ ---</u>	<u>\$ 6,464,470</u>

NOTE F - Demand Obligation Payable

Certain costs were incurred in connection with the start-up of the Authority. These costs, which are standard and typical for the first several years of operation, were financed with bond proceeds that, under certain circumstances, could revert to the respective townships. Effective August 14, 2000, the Authority, pursuant to township resolution, became contractually obligated to Brady and Pavilion Townships in the aggregate amount of \$150,000. During the year ended 2005, Brady and Pavilion Township forgave the \$150,000 demand obligation and interest accrued to that date of \$26,833. The forgiveness of the debt was recorded as contributed assets.

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE G - Changes in Long-term Debt

The following is a summary of debt transactions of the Authority for the years ended March 31, 2005 and 2004:

	Sewer Contract Debt		
	Kalamazoo County	Other	Total
DEBT PAYABLE, APRIL 1, 2004	\$ 5,400,000	\$ 70,520	\$ 5,470,520
Debt retired	(325,000)	---	(325,000)
DEBT PAYABLE, MARCH 31, 2004	5,075,000	70,520	5,145,520
Debt retired	(325,000)	---	(325,000)
DEBT PAYABLE, MARCH 31, 2005	<u>\$ 4,750,000</u>	<u>\$ 70,520</u>	<u>\$ 4,820,520</u>

The contract debt payable at March 31, consists of the following issues:

	2005	2004
\$6,100,000 Kalamazoo County General Obligation Bonds dated December 1, 1998, due in annual principal installments ranging from \$325,000 to \$400,000 through June 1, 2017, plus interest payable semi-annually on June 1 and December 1 of each year at 4.15% to 4.30%.	\$ 4,750,000	\$ 5,075,000
\$70,520 Contract payable to City of Portage for excess capacity, interest accrues at 4.4% annually, due in annual installments of \$14,104 plus interest beginning September 1, 2005, final payment is due September 1, 2009.	70,520	70,520
	<u>4,820,520</u>	<u>5,145,520</u>
Less current maturities	<u>(350,000)</u>	<u>(325,000)</u>
TOTALS	<u>\$ 4,470,520</u>	<u>\$ 4,820,520</u>

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE G - Changes in Long-term Debt (Continued)

The annual minimum annual debt service requirements, including interest, for long-term debt outstanding as of March 31, 2005 are as follows:

Years Ending March 31,	Principal	Interest	Totals
2006	\$ 364,104	\$ 199,040	\$ 563,144
2007	364,104	184,698	548,802
2008	364,104	170,269	534,373
2009	364,104	155,840	519,944
2010	364,104	141,672	505,776
2011-2015	1,850,000	448,188	2,298,188
2016-2018	1,150,000	75,250	1,225,250
TOTALS	\$ 4,820,520	\$ 1,374,957	\$ 6,195,477

For the years ended March 31, 2005 and 2004, the Authority paid interest costs of \$211,023 and \$229,725, respectively. The Authority did not capitalize any interest charges during the years ended March 31, 2005 and 2004.

NOTE H - Retirement Plan

The Authority adopted a simple IRA Plan in fiscal year 2003, which allows employees to contribute up to \$6,000 per year to the plan. The Authority is required to make a contribution to the plan annually, as defined in the plan document. Contributions to the plan totaled \$1,310 and \$1,203 for the years ended March 31, 2005 and 2004, respectively.

NOTE I - Non-cash Activities

For the year ended March 31, the Authority had the following non-cash activity:

	2005	2004
Assessment rolls added	\$ ----	\$ 35,080
Connection fee contracts added	\$ 62,410	\$ 104,000
Demand obligation payable plus accrued interest payable contributed to Authority	\$ 176,835	\$ ---

SOUTH COUNTY SEWER AND WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended March 31, 2005 and 2004

NOTE J – Insurable Risk

The Authority in the normal operation of its activities has exposure for damage to residential and commercial property and personal injury resulting from the operation or construction of its sewer system. The Authority Board has elected to self-insure against this risk. The Authority Board believes that funds accumulated and restricted for significant replacements, as disclosed in Note D, are adequate to cover the associated risk.

SUPPLEMENTAL INFORMATION

SOUTH COUNTY SEWER AND WATER AUTHORITY
SCHEDULE OF OPERATING EXPENSES COMPARED TO BUDGET
For the Year Ended March 31, 2005
(Comparative Actual Amounts for the Year Ended March 31, 2005)

	2005		Variance –	2004
	Budget	Actual	Favorable (Unfavorable)	Actual
Salaries and wages	\$ 49,031	\$ 49,166	\$ (135)	\$ 52,046
Fringe benefits:				
Social security	3,784	3,758	26	3,684
Insurance	4,920	4,790	130	3,056
Retirement	1,311	1,311	---	1,203
	<u>10,015</u>	<u>9,859</u>	<u>156</u>	<u>7,943</u>
Contracted services:				
Insurance/workman's compensation	6,540	6,301	239	5,965
Contracted services	21,025	25,120	(4,095)	17,368
Treatment charges	36,572	38,225	(1,653)	28,725
Engineering	2,000	470	1,530	---
Publications/ printing	100	84	16	98
Audit	3,750	3,700	50	3,500
Legal	2,500	506	1,994	4,510
Mileage/travel/entertainment	750	336	414	418
Miss dig fees	400	371	29	---
Rent	2,400	2,400	---	2,400
Bank fees	100	42	58	31
Alarm system	400	---	400	---
Education and subscriptions	300	---	300	---
	<u>76,837</u>	<u>77,555</u>	<u>(718)</u>	<u>63,015</u>
Utilities:				
Electric and gas	10,000	10,297	(297)	10,019
Telephone	1,500	1,257	243	2,086
	<u>11,500</u>	<u>11,554</u>	<u>(54)</u>	<u>12,105</u>
Supplies:				
Postage	1,200	1,141	59	1,180
Office	4,600	2,060	2,540	2,303
	<u>5,800</u>	<u>3,201</u>	<u>2,599</u>	<u>3,483</u>
Maintenance and repairs:				
General maintenance	500	916	(416)	2,964
Repairs and maintenance reimbursement	2,000	3,610	(1,610)	783
	<u>2,500</u>	<u>4,526</u>	<u>(2,026)</u>	<u>3,747</u>
Miscellaneous	631	---	631	---
TOTALS, EXCLUDING DEPRECIATION	<u><u>\$ 156,314</u></u>	<u><u>\$ 155,861</u></u>	<u><u>\$ 453</u></u>	<u><u>\$ 142,339</u></u>

See Accompanying Independent Auditors' Report

**SOUTH COUNTY SEWER AND WATER AUTHORITY
SCHEDULE OF PRINCIPAL AND INTEREST PAYMENTS
\$6,100,000 KALAMAZOO COUNTY GENERAL OBLIGATION BONDS
DATED DECEMBER 1, 1998
For the Year Ended March 31, 2005**

Years Ending March 31,	Rate	Principal June 1	Interest		Totals
			June 1	December 1	
2006	4.25	\$ 350,000	\$ 101,687	\$ 94,250	\$ 545,937
2007	4.30	350,000	94,250	86,725	530,975
2008	4.30	350,000	86,725	79,200	515,925
2009	4.30	350,000	79,200	71,675	500,875
2010	4.15	350,000	71,675	64,412	486,087
2011	4.25	350,000	64,412	56,975	471,387
2012	4.30	375,000	56,975	48,913	480,888
2013	4.30	375,000	48,912	40,850	464,762
2014	4.30	375,000	40,850	32,788	448,638
2015	4.30	375,000	32,788	24,725	432,513
2016	4.30	375,000	24,725	16,662	416,387
2017	4.30	375,000	16,663	8,600	400,263
2018	4.30	400,000	8,600	---	408,600
TOTALS		<u>\$ 4,750,000</u>	<u>\$ 727,462</u>	<u>\$ 625,775</u>	<u>\$ 6,103,237</u>

See Accompanying Independent Auditors' Report

SEBER TANS, PLC

CONSULTANTS & CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Commissioners and
General Manager of South County
Sewer and Water Authority

In planning and performing the audit of the financial statements of South County Sewer & Water Authority for the year ended March 31, 2005, we considered the Authority's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control system that, in our judgment, could adversely affect South County Sewer & Water Authority's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following reportable conditions that we believe to be material weaknesses.

Separation of duties

Due to the small size of the Authority's office staff (two personnel), separation of duties is limited. The office manager has access to assets, recording of the assets and reconciliation functions. The general manager initiates and authorizes all significant transactions. As a result, the risk of loss, error, or irregularities of assets increases. We recommend that the Authority Supervisors review key financial reports and reconciliations periodically for unusual matters. In addition, fidelity bonds as discussed below should adequately cover all personnel with access to accounting records and assets of the Authority.

Employee bonding

The Authority has bonded its employees and Board members for \$100,000. The Authority has cash and highly liquid assets well in excess of \$1,000,000. We recommend that the Authority increase its bond coverage.

We also noted the following reportable conditions that are not believed to be material weaknesses.

Collateralizing bank balances in excess of \$100,000

The Authority maintains several cash accounts with a bank. The balances exceed the FDIC insurance limit of \$100,000. Should the bank fail, the Authority may incur a loss if the cash invested at the bank exceeds the insurance limits. We recommend that the Authority monitor the financial condition of the bank and that it continue its efforts to obtain collateral for balances in excess of FDIC insurance limits. The Authority may request banks to pledge securities for payment of any uninsured losses or it may consider investing in other insured financial instruments.

Evaluation of debt repayment

The assessment receivable balance is considerably less than the bond payable balance. Additionally, interest rates on investments are at a historically low rate. These conditions may result in early payoffs of assessments receivable and add to the difficulty of repaying the bonds. We recommend that the Authority continue their annual evaluation of the bond repayment schedule and take all necessary steps to provide for the payment of its long-term debt, including increasing debt service payments.

This report is intended solely for the information and use of the Board of Commissioners and Management of South County Sewer & Water Authority, and is not intended to be and should not be used by anyone other than these specified parties.

Seber Tans, PLC

Seber Tans, PLC
June 6, 2005